

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Charmer Water Company, Cherry Hill)	
Water Company, Clarendon Water)	
Company, Killarney Water Company,)	
Ferson Creek Utilities Company,)	Docket Nos. 11-0561 through 11-0566
Harbor Ridge Utilities, Inc.)	(cons.)
)	
)	
Proposed Increase in Water and)	
Sewer Rates)	

INITIAL BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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The People of the State of Illinois, by LISA MADIGAN, Attorney General of the State of Illinois (the “People,” or “AG”), pursuant to the Commission’s rules, 83 Ill. Admin. Code 200.800, file their Initial Brief in response to the request of Charmer Water Company, Cherry Hill Water Company, Clarendon Water Company, Killarney Water Company for a substantial increase in revenues for water service, and of Ferson Creek Utilities Company and Harbor Ridge Utilities, Inc. for substantial increases in revenues for water and sewer customers in Illinois.

I. STATEMENT OF FACTS

This consolidated docket involves the request of six utilities, all of which are wholly owned by Utilities, Inc. (“U” or “the Company”), to increase the rates for water and/or sewer services provided to Illinois residents. The utilities whose rates are at issue are: (1) Charmer Water Company (“Charmer”); (2) Cherry Hill Water Company (“Cherry Hill”); (3) Clarendon Water Company (“Clarendon”); (4) Killarney Water Company (“Killarney”); (5) Ferson Creek Utilities Company (water and sewer service) (“Ferson Creek”); and (6) Harbor Ridge Utilities, Inc., water and sewer service (“Harbor Ridge Water”) (collectively referred to as the “Utilities”). The Utilities all use the same central management company, the Water Services Corporation, another wholly owned subsidiary of the Company, to perform all of their administrative tasks such as accounting, administration, billing, operations, and other tasks. *See, e.g.*, Charmar Ex. 1.0 at 2.

The Utilities serve a small number of customers and are scattered across several counties. Their last rate orders range from 1985 to 2004 as shown below:

Table 1. Number of Customers and Locations of Utilities.

Utility Name	No. of Customers	County	Last Rate Order
Charmar	53	Lake	April 7, 2004
Cherry Hill	259	Will	April 7, 2004
Clarendon	363	DuPage	August 26, 1998
Killarney	346	McHenry	May 24, 1995
Ferson Creek	378 (water) / 370 (sewer)	Kane	June 21, 1984
Harbor Ridge	319 (water) / 316 (sewer)	Lake	October 23, 1995

Source: : Charmar Ex. 1.0 at 3; Cherry Hill Ex. Ex. 1.0 at 3; Clarendon Ex. Ex. 1.0 at 3; Killarney Ex. Ex. 1.0 at 3; Ferson Creek Ex. Ex. 1.0 at 3; Harbor Ridge Ex. Ex. 1.0 at 3.

While the number of customers in each system is small, the increases requested in their surrebuttal testimony are extraordinarily large ranging from a low of 77% to a high of 284%, as shown by the following table, taken from AG Exhibit 2.0. Although the revenue increases requested are all extremely large, the current rate levels of the various utilities are quite disparate, and the changes requested will not result in more similar rates as shown in table 3.

Table 2: Proposed Revenue Increases -- Rebuttal

Operating Company	Present Revenue	Rebuttal Proposed Revenue	Rebuttal Revenue Increase	Percent Increase
Charmar Water	\$ 25,058	\$ 96,199	\$ 71,141	284%
Cherry Hill Water	\$ 85,528	\$ 169,813	\$ 84,285	99%
Clarendon Water	\$ 94,516	\$ 226,459	\$ 131,943	140%
Killarney Water	\$ 66,901	\$ 206,276	\$ 139,375	208%
Ferson Creek Water	\$ 98,715	\$ 180,665	\$ 81,950	83%
Ferson Creek Sewer	\$ 132,779	\$ 234,582	\$ 101,803	77%
Harbor Ridge Water	\$ 77,704	\$ 141,594	\$ 63,890	82%
Harbor Ridge Sewer	\$ 31,789	\$ 64,684	\$ 32,895	103%
Total Amounts	\$ 612,990	\$ 1,320,272	\$ 707,282	

Table 3**Utilities, Inc. Typical Residential Bill Increases**

Operating Company	Present Avg. Res. Bill	Proposed Avg. Res. Bill	Bill Increase	Percent Increase
Charmar Water	\$ 61.95	\$ 142.78	\$ 80.83	130%
Cherry Hill Water	\$ 26.42	\$ 52.23	\$ 25.81	98%
Clarendon Water	\$ 24.98	\$ 55.77	\$ 30.79	123%
Killarney Water	\$ 15.48	\$ 47.66	\$ 32.18	208%
Ferson Creek Water	\$ 21.44	\$ 38.06	\$ 16.62	78%
Ferson Creek Sewer	\$ 29.50	\$ 52.27	\$ 22.77	77%
Harbor Ridge Water	\$ 19.06	\$ 34.99	\$ 15.93	84%
Harbor Ridge Sewer	\$ 19.62	\$ 16.69	\$ 8.87	113%

Source: Utilities Ex. 1.0 at 9-10 for volumes; Utilities Ex. 5.1, page 2 for rates.

The large changes in rates requested for these systems require the Commission to carefully consider the bases for the utilities' requests, and allow a phase-in of large increases so that consumers can accommodate the increases into their budgets going forward.

II. ARGUMENT — INTRODUCTION

This Commission should substantially reduce the proposed revenue increases for each Utility. Each request includes expenses that are unreasonable and that unnecessarily and unfairly drive the requested revenues to extraordinary levels, putting an impossible burden on consumers. Further, the Commission should modify the allowed return on equity to reflect the imprudent management that spent millions of dollars on extremely small systems without incrementally increasing revenues to cover expenses. By waiting between eight and 28 years to seek a single, huge rate increase, the utilities have deprived the Commission and utility management of the vital ability to *gradually* change rates and investments, and avoid the rate shock that consumers facing water and sewer rates suddenly ranging up to \$142 a month will experience.

The People presented the testimony of Michael L. Brosch, who testified that the utilities have failed to show that their requests for substantial cash working capital allowances and rate

case labor expense are reasonable and necessary. In addition, the People will address the appropriate return on equity for these utilities. Finally, the People will address rate shock, the public comment about the size of requested rate increases, and discuss the phase-in plan developed by Mr. Brosch in response to the undeniable rate shock that could result from the increases requested herein.

A. The Utilities’ Calculation Of Their Revenue Requirements Is Over-stated Due to the Double Recovery of Labor Costs and the Erroneous Cash Working Capital Allowance.

1. The Company’s Treatment of Labor and Rate Case Internal Expenses Is Highly Unusual, and Unreasonably Burdens Very Small Systems With Extraordinarily Large Rate Case Expenses.

Ordinarily, a utility will have an expense for employees or a “labor” expense to cover the cost of employees who provide operational, financial, regulatory or other services for the utility. None of the utilities in these dockets has any direct employees, however. Tr. at 48. Instead, each utility includes an allocated labor expense from the Water Services Corporation (WSC), which is also a wholly owned subsidiary of the utilities’ parent, Utilities, Inc. The allocation is based on the number of customers for each system, or “equivalent residential connection,” compared to the number of customers in all of the UI regulated utilities. Tr. at 74.

The labor cost allocated to each utility is relatively small. However, each utility has also included an allegedly “direct allocation” for rate case services provided by WSC employees. As shown by the following table, this “direct” allocation of WSC employee costs dwarfs the direct allocation, and produces a labor cost that is grossly out of proportion to the size of the utility that is expected to cover the labor cost.

Table 4: Internal WSC Labor Cost to Rate Case Internal Labor

Utility (a)	Number of Employees (b)	Internal Labor Cost Allocation (c)	WSC Rate Case Captive Deduction (d)	Rate Case Internal (WSC) Labor Cost (e)
Charmar	53	\$4,033	\$283	\$79,339
Cherry Hill	259	\$23,944	\$1,409	\$76,339
Clarendon	363	\$35,108	\$1,939	\$77,109
Killarney	346	\$31,169	\$2,405	\$76,823
Ferson Creek	378 (water) 370 (sewer)	\$35,591W \$35,852 S	\$1,988 \$1,988	\$38,682 \$38,682
Harbor Ridge	319 (water) 316 (sewer)	\$22,114 W \$25,722 S	\$1,977 \$1,958	\$40,195 \$40,195
TOTAL		\$213,533	\$13,947	\$537,826

Sources: Co. Ex. 3.1, page 8; AG Ex. 2.4 (w/p[b-2]; AG Cross Ex. 2.

The Commission should reject this allocation of internal labor for rate case expense shown in column (e) to these small utility systems, and find that it is unreasonable and inconsistent with the treatment of this expense by other Illinois utilities.

Mr. Brosch is a regulatory accountant with extensive experience reviewing the rate requests of utilities all over the country. AG Ex. 1.1 and 1.2. He testified that the “inclusion of labor costs for Company employees is unusual and creates a problem of over-recovery of labor costs if approved by the Commission. The typical recovery of rate case expenses is limited to non-labor costs because of these problems.” AG Ex. 1.0 at 23. In response to an AG data request, the Company admitted that it allocates all of the WSC labor cost to the operating utilities, and that no additional employees are hired to handle rate cases. AG Ex. 1.0 at 23. In light of the fact that no additional employees are hired to handle rate cases, it is inconceivable

and unreasonable to charge ratepayers more than twice as much for internal, WSC labor for rate case expense than these systems pay for all other WSC personnel costs (compare \$213,533 to \$537,826). A more appropriate treatment of internal rate case labor would be to allow one allocation of rate case expense that is representative across the system, which the company has identified in workpapers as \$13,947. This “adds back” the “cap time” rate case deduction the utilities proposed to cover rate case expenses elsewhere in their system. AG Exhibit 2.4 shows the adjustments to test year expenses after the rate case “cap time” is included in the test year. This is responsive to utility witness Georgiev’s concern that it is inequitable to remove ALL rate case expense. AG Ex. 2.0 at 24 (lines 464-477).

The need for this adjustment is demonstrated by the fact that although the utilities reduced *test year* labor expenses for WSC labor expenses that are direct billed (see Table 3 above), in this case the test year is 2009, the direct billed labor expenses are from 2011 and 2012. The full cost of WSC employees has already been accounted for in the 2009 test year, creating a mix-match between the very small direct bill adjustment for the 2009 test year (\$13,947) and huge direct allocation adjustment (\$537,826) applied to these tiny utilities for *internal* rate case expense and creating a double recovery of the WSC labor cost – adding 2011 and 2012 costs to the 2009 test year cost.

The Commission should reject Company’s request to directly allocate internal labor rate case expense to the individual utilities. As Mr. Brosch explained and as demonstrated in Table 3, above, each utility reduced the test year labor cost by a much smaller amount of directly allocated (or capitalized) rate case cost than is included within the Companies’ asserted rate case

expenses. As a result, consumers will pay the same salaries twice: once through operating expenses and again through rate case expense recoveries. See AG Ex. 1.0 at 23. This is unfairly burdens small systems with rate case costs that dwarf their ordinary operating expenses.

The Utilities' witness argued that in prior cases the Commission has allowed it to recover the historical test year allocated internal WSC cost plus an allocation for rate case. Co. Ex. 3.0 (Georgiev Rebuttal) at 17. However, the Staff's endorsement of the Company's allocation methods in the prior case was equivocal at best. Company witness Georgiev recalled that the Staff witness she referred to in her rebuttal testimony "was concerned that the salaries would be overstated during years in which the companies are not involved in rate cases" and "that he suggested that the companies provide in future rate cases a detailed explanation of how the utility and the WSC salaries are determined in total located to the individual utility and directly charged to rate case expense and other cap-time categories." Tr. at 96-98. However, the Company did not offer any further explanation or do anything different in this case than in the prior case. *Id.*

Mr. Brosch's analysis of the Company's allocation method demonstrates that the concerns stated in the prior case were well-founded, and that Company's approach will result in Illinois consumers being over-charged by mis-matching a historical, 2009 test year with 2011-2012 internal labor costs. In order to remove this over-charge, the Commission should reduce the utilities' labor expense by a total of \$537,826 as shown above for each utility. As Mr. Brosch further pointed out: "the relatively small amounts of recorded capitalized rate case hours and dollars are not presented or explained by Ms. Georgiev in her Rebuttal, making it impossible to determine from her Rebuttal the net effect of the Companies' proposed adjustments. However, when much large projected rate case hours and costs are accumulated and amortized as rate case

expense prospectively, an over-recovery of more than \$300,000 can be expected [to] occur over the period of rate case expense amortization.” AG Ex. 2.0 at 25, Lines 482-488.

In addition to trying to charge the Illinois consumers of these companies more than \$500,000 for WSC rate case labor, UI has rate cases pending in several other states and has rate cases pending in Illinois in 2010, 2011 and this year. There are several cases pending in Florida,¹ and rate cases are pending in Indiana, is pending, in Kentucky, Louisiana, North Carolina, Nevada, and Pennsylvania.² UI has not shown that Water Services Corporation personnel have been fairly assigned to these small Illinois companies, particularly when so many other rate cases are pending both locally and nationally.

The People request that the Commission remove \$537, 826 in total from operating expenses shown on Co. Exhibit 3.1, page 8, and add in \$13,947 as shown in the table above to fairly and accurately account for WSC rate case expenses attributable to each utility.

2. The Commission Should Not Allow The Utilities To Charge Consumers For Cash Working Capital Costs Based On Unsupported Assumptions and An Outdated and Erroneous Model.

The Utilities seek to increase their rate bases by the following amounts, allegedly to reflect the cost to fund ongoing operations. The People maintain that the utilities’ requested rate base should be reduced to remove the cash working capital allowance, as shown in the following table:

¹ Labrador Utilities Docket No. 110264-WS; Lake Placid Utilities Docket No. 090531-WS; Lake Utility Services Docket No. 100426-WS; Sanlando Utilities Docket No.110257-WS; Utilities, Inc. of Eagle Ridge Docket No. 110153-SU; Utilities, Inc. of Florida Docket Docket No. 110142-WU

² Indiana: Twin Lakes Docket No. 43957; Water Service Corporation of Kentucky Docket No.2010-00476; Louisiana Utilities, Inc. of Louisiana Docket No. U-31159; North Carolina, Brandfield Farms Water Company Docket No. W-1044 CWS Systems Docket No.W-778 Carrituck Club Docket No. W-354; Nevada, Spring Creek Docket No.11-12032, and Pennsylvania, Penn Estates Utilities Docket No. R-2011-2255159.

Table 5: Cash Working Capital

Utility (a)	Utility's Cash Working Capital Rate Base Allowance (b)	AG Cash Working Capital Adjustment to Rate Base (c)
Charmar	\$8,196	\$(8,196)
Cherry Hill	\$12,389	\$(12,389)
Clarendon	\$18,173	\$(18,173)
Killarney	\$14,008	\$(14,008)
Ferson Creek -W	\$11,628	\$(11,628)
Ferson Creek - S	\$17,789	\$(17,789)
Harbor Ridge – W	\$8,973	\$(8,973)
Harbor Ridge - S	\$7,236	\$(7,236)

Sources: Charmar Ex. 1.1, Sch. C, page 1, Line 6, Col. D; Cherry Hill Ex. 1.1, Sch. C, page 1, Line 6, Col. D, Clarendon Ex. 1.1, Sch. C, page 1, Line 6, Col. D, Killarney Ex. 1.1, Sch. C, page 1, Line 6, Col. D, Ferson Creek Ex. 1.1, Sch. C, page 2-3, Line 6, Col. D, Harbor Ridge Ex. 1.1, Sch. C, page 2-3, Line 6, Col. D; AG Ex. 1.3, Col. (c), Adjustment 2 Rate Base.

Cash working capital (“CWC”) represents the funds required to finance the day-to-day operations of the utility business and can increase or decrease rate base depending on whether it is “positive” or “negative”. See, e.g., ICC Docket 10-0467 Final Order at 42. In this docket the utilities requested increases in rate base on the assumption that they have “positive” cash working capital balance that must be funded by shareholders. It is undisputed, however, that the utilities in this case did not perform a utility specific study to determine whether they in fact have a revenue lag that requires shareholder funding. Tr. 104-105. Instead, they claim CWC based on a 45-day formula approach that is both obsolete and contradicted by the evidence directly applicable to the utilities.

AG witness Mr. Brosch described the 45-day CWC formula as:

“based upon an incorrect general assumption that it takes the utility 45 days longer to collect its revenues than it can effectively delay paying its expenses. This so-called 1/8th of expenses or 45-day formula is believed to have been first applied in a 1929 Interstate Power rate case before the Federal Power Commission based upon that utility’s circumstances at that time, and has continued to be used and abused in the regulation of mostly small utilities ...

Mr. Brosch pointed out that the assumptions underlying the 45 day formula approach are not reasonable and do not comport with the actual cash flow of utilities today. As Mr. Brosch pointed out:

“For example, with monthly billing and average customer remittances within 30 days of billing month-end, the overall cash revenue lag might be approximately 45 days; including one-half of the billing month which is about 15 days, plus another 30 days waiting for customer remittances. In this example, the cash working capital based on 45 days could theoretically apply, **but only if the utility paid its employees and vendors instantly on every day they provide labor, services and materials to the utility, causing there to be no delay in the outflow of cash to fund operating expenses. We know, however, that vendors and employees are not paid immediately at the end of each day. We also know that payroll taxes and income taxes are payable only after the pay periods and subject to statutory dates that yield considerable cash flow retention by the utility.**

AG Ex. 1.0 at 19 (emphasis added). The utilities do not pay their employees and vendors instantaneously, and there is no evidence showing that there is an actual lag in receipt of revenues from consumers that exceeds the lag in time the utilities take to pay their employees, vendors, and other expenses. Consumers should not be asked to pay increased rates due to phantom CWC capital costs.

The utility did not address any of the specific factors that Mr. Brosch identified as showing that the cash flow of the utilities should not result in a CWC allowance, including that the Utilities are all moving to monthly billing and the Company maintains “a centralized cash management system where customer deposit accounts are swept into a single depository account and all checks are written from a single disbursement account.” AG Ex. 1.0 at 20-22. Consumers

should not be asked to provide a return on CWC in the absence of specific evidence supporting the need for investor-supplied capital to cover a real – as opposed to an assumed – revenue lag.

The People request that the Commission remove CWC from rate base and not charge ratepayers for these non-existent capital costs.

B. The Commission Should Reduce The 9.43% ROE Accepted By The Utilities and Proposed by the Staff.

3. The Return on Equity Allowed the Utilities Should Be No More Than The Average of the ROEs of the Water Utilities Included in the Staff Analyses.

A key component of the revenue requirement is the return on capital invested in the utility. The overall, weighted cost of capital includes the cost of short-term and long-term debt and the return on common equity (ROE) paid to investors. As Staff witness Freetly pointed out, “[a]ccording to financial theory, the market-required rate of return on common equity is a function of operating and financial risk. Thus, the method used to select a sample should reflect both the operating and financial characteristics of a firm. ... The key factors of a utility’s business risk profile are markets and service area economy; competitive position; operations; regulation; and management.” Staff Ex. 3.0 at 13. Ms. Freetly used both water and non-water utility samples in reaching her proposed ROE. The People maintain that her equal weighting of non-water utility samples skewed her results upward, causing consumers to pay shareholders a higher profit than is appropriate for the water and sewer services at issue in this case.

Staff witness Freetly presented the results of her DCF and CAPM analyses on both water and non-water utility samples. The result of her DCF water sample analysis was an ROE of 8.84% and the result of her CAPM water sample analysis was an ROE of 9.23%. Staff Ex. 3.0. Sch. 3.8 & 3.9. However, Ms. Freetly recommended a 9.43%

ROE for these utilities that exceeds both of these averages. She increased the water utility required ROE by incorporating the results for utilities that offer different services, in different markets, in different states, with different economic and competitive pressures, different regulators, and that have different operations.

The evidence in this docket shows (1) that these water and/or sewer utilities had access to capital for between eight and 28 years, demonstrating that they were able to access capital at existing rate levels and to continue to invest in needed infrastructure; and (2) that water utilities in general have a lower cost of equity than other utilities. See Staff Ex. 3.0, Sch. 3.8 & 3.9. The Commission should not require the consumers of these small utilities, who are facing increases of 77% to 280%, to pay a higher profit level in their rates than is necessary. UI's shareholders are not entitled to a profit from Illinois consumers commensurate with the profit found in an industry that UI does not participate in, and the Commission should not include the DCF or CAPM results for non-water utilities in its assessment of these utilities' cost of equity.

In the landmark case of *Bluefield Waterworks Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923), the United States Supreme Court established that a utility's profit, or return on equity, should be equal to that generally made by other firms at the time, in the same general area, and on investments presenting corresponding risks and uncertainties. *Id.* at 692-693. Utilities that provide an essential public service, such as water and sewer services, are not entitled to profits commensurate with those realized on speculative ventures or ventures involving other types of services or products. *Id.* Water and wastewater service are not equivalent to energy services, such as those included in the Staff utility sample, where alternative fuels are available,

where competition for commodities is developing, where the parent companies are diversified into both regulated and non-regulated operations, where infrastructure projects and demands are unique to energy, and where carbon and other pollution concerns are driving efficiency and other industry efforts. It is not reasonable to increase the profit level of tiny water companies like those at issue by treating major energy utilities (e.g. Ameren) as comparable.

Staff witness Freetly's recommended ROE of 9.43% is a simple average of the water and non-water DCF and CAPM samples. The Commission should not include the non-water utility samples in its conclusions, however. Removing the effect of the *non-water utilities* from Staff witness Freetly's recommendation, and simply averaging her *water utility* sample DCF and CAPM results produces an ROE of 9.035% (DCF result of 8.84% plus CAPM result of 9.23% divided by two). This reduction to the Staff recommendation more accurately reflects the profit level that consumers of water and sewer utilities should be required to provide shareholders. **An ROE of 9.035% results in a weighted cost of capital of 7.79%³** and should be adopted by the Commission in this proceeding, before adjustment for utility specific poor management.

4. The Utilities' Failure to Manage Their Systems to Gradually Increase Revenues and Spending Will Unfairly and Unreasonably Burden Consumers and Should Result in a Reduction in the ROE That A Properly Operated Water Utility Should Receive.

In ordinary competitive markets, companies that mismanage their operations or over-price their products are expected to suffer lower profits. The Commission should impose the same discipline on the UI companies in this case. Staff witness Freetly admitted that she did not consider the specific operating or management characteristics of

³ As shown in Staff Ex. 3.0, Sch. 3.1, the weighted cost of equity at 9.035% is calculated as $(49.27 * .09035 = 4.45\%) + 3.30 \text{ (long term debt)} + 0.04 \text{ (short term debt)} = 7.79\%$.

the utilities under review. She did not consider, inter alia, the length of time between rate cases, the size of the requested revenue increase, customer impact, water quality or any other management issue in conducting her analysis or proposing an ROE. Tr. 284-288. Yet it is clear that increases of 77% to 280% are extraordinary and place unreasonable burdens on consumers who will suddenly face the steep increases in the price of a vital commodity, without which their homes are uninhabitable.

During the years that these utilities operated at current revenues, UI chose to invest more than \$2.7 million in the various systems, as shown in the following table:

Table 6: Net Plant Additions

Utility (a)	Net Plant Additions
Charmar	\$260,000
Cherry Hill	\$400,000
Clarendon	\$400,000
Killarney	\$600,000
Ferson Creek -W Ferson Creek - S	>\$1,000,000
Harbor Ridge – W Harbor Ridge - S	\$84,000

Source: Rebuttal Testimony of Bruce T Haas.

The Company's investments do not appear to have been made with regard to how great of an effect they will have on consumer rates. Given the small number of customers served by each of these systems, the investments should have been spaced so that the effect on rates would not have been so drastic.

These utilities avoided regulatory scrutiny for many years, while pouring investment into systems that are now being offered for sale by their owner, Highstar Capital. AG Ex. 2.0 at lines 288-303 and footnotes. The Commission is now faced with the unenviable task of approving

rate increases that defy the fundamental principle of ratemaking that changes in cost and in rates should be done gradually so that the public can accommodate changed rate levels and the Commission can monitor such changes. The huge increases requested in these dockets show poor management both by incurring costs so greatly in excess of what consumers can reasonably be expected to pay, and in delaying the request for an increase to cover costs. Both of these poor decisions harm consumers, who will be burdened by sudden increases in costs for monopoly water and/or sewer service.

In reviewing the range of rates that are constitutionally permissible, the Illinois courts have stated:

The rate established must be just and reasonable, both to the public and to the utility. In *Public Service Gas Co. v. Utility Com'rs*, 84 N. J. Law, 463, 87 Atl. 651, L. R. A. 1918A, 421, it is said that a just and reasonable rate can never exceed-perhaps can rarely equal-the value of the service to the consumer, and on the other hand it can never be made by compulsion of public authority so low as to amount to confiscation; that a just and reasonable rate must therefore certainly fall between these two extremes, so as to allow both sides to profit by the conduct of the business and the improvement of methods and increase of efficiency; that justice to the consumer, ordinarily, would require a rate somewhat less than the full value of the service to him, and justice to the company would ordinarily require a rate above the point at which it would become confiscatory.

State Public Utilities Commission v. Springfield Gas & Elec. Co., 291 Ill. 209, 216 -217

(Ill.1919). In a case where a water utility requested a 110% increase in rates, and the Commission denied the request but failed to specify the bases for its calculation of the allowed revenue level, the Court held that the error was not in denying the full requested increase, but in failing to state the components of the rate (e.g., operating revenues, expenses, rate base, rate of return). The Court said: “We are not particularly concerned with the computations utilized by the Commission to arrive at any of these figures so long as they are not against the manifest weight of the evidence, but [it] is imperative that the Commission state what the final amount of

each is.” *Camelot Utilities v. Illinois Commerce Commission*, 51 Ill.App.3d 5, 9, 365 N.E.2D 312, 315 (1977). The Court concluded that: “While the rates allowed can never be so low as to be confiscatory, within this outer boundary, if the rightful expectations of the investor are not compatible with those of the consuming public, it is the latter which must prevail.” 51 Ill.App.3d at 10, 365 N.E.2d at 315.

As a result of the failure of UI and these individual utilities to fairly and reasonably manage their operations to avoid rate shock and to properly tailor their expenses so that increases are gradually timed to accommodate the burden that increases place on the public for essential water service, the Commission should adjust the ROE based on the Staff’s water sample downward. As Staff witness Freetly testified, it is the Commission’s responsibility and discretion to impose a downward adjustment on the ROE based on factors other than the basic DCF or CAPM analyses. Tr. at 287-288.⁴ The People recommend a reduction of 100 basis points, resulting in an **ROE of 8.035% and a weighted cost of capital of 7.30%**. The People note that this ROE is higher than the ROE of one of the utilities in Ms. Freetly’s sample (Middlesex Water, 7.47%) and still preserves the same short and long-term debt costs in the capital structure. As the Court held in *Camelot*, supra, so long as the Commission specifies the basis for allowed revenues, the Court will defer to a downward adjustment to revenues necessary to properly balance shareholder and ratepayer interests.

The People request that the Commission authorize a weighted cost of capital to be applied to rate base of no more than 7.30% as described above.

⁴ Ms. Freetly testified as follows: Q: And then it would be up to the Commission to determine whether that should be modified to reflect other factors that might affect consumers or the company?
A. That would be at the Commission's discretion, yes.

C. The Commission Should Adopt a Phase-In Approach for the Utilities' Huge Increases in Order to Ameliorate the Impact of Rate Shock on Consumers.

1. The extreme size of the requested rate base increases will cause rate shock on consumers.

As demonstrated above in Table **, above, the utilities propose extraordinarily large increases in this docket. These are undeniably large increases for an essential service. As AG witness Brosch commented: "Most customers facing water bills that may increase from 77 to 284 percent in a single month will undoubtedly be shocked by the size of the increase." AG Ex. 2.0 at 6.

The avoidance of "rate shock" is a well-established regulatory principle and has guided this Commission in determining appropriate utility rates. *See, e.g., Citizens Utils. Bd. V. Ill. Commerce Comm'n*, 276 Ill. App. 3d 730, 738, 658 N.E.2d 1194, 1201 (1st Dist. 1995); *Camelot Utils., Inc. v. Ill. Commerce Comm'n*, 51 Ill. App. 3d 5, 10, 365 N.E.2d 312, 315 (3d Dist. 1977). Staff witness Rukosuev described rate shock as follows: Rate shock occurs when a customer purchasing a commodity, such as water, must pay a significantly higher amount for comparable service. While customers generally do not expect prices to remain unchanged forever, they also typically do not expect an abrupt and extreme change in prices that could cause them significant financial distress." Staff Ex. 5.0 at 32. At least one Illinois court has recently recognized that the concept of "rate shock" is a close relative to the doctrine of promissory estoppel. *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, 398 Ill. App. 3d 510, 525-26, 924 N.E.2d 1065, 1083-84 (2d Dist. 2009). Illinois law imposes certain duties on regulated utilities; the most essential duty is to offer rates that are "just and reasonable." 220 ILCS 5/9-101 (2011). That obligation is grounded in the ratemaking formula and the regulatory compact, requiring that the utility request rates that are necessary to cover its costs and to provide a fair and reasonable

return to its investors. *See Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 54, 25 N.E.2d 482, 494 (1939); *see also Ill. Bell Telephone Co. v. Ill. Commerce Comm’n*, 414 Ill. 275, 289, 111 N.E.2d 329, 337 (1953). Consumers are entitled to rely on the regulatory compact, and thus may reasonably expect both that the rates will change gradually over time, and that the utility company will fulfill its obligation to assure that the gap between rates and costs does not become too excessive. The Commission should not accept the shocking rate increases requested in this docket as reasonable, fair, or lawful in light of the utilities’ obligation to the public to only charge “just and reasonable” rates and to avoid rate shock.

The utilities and the Staff witnesses have commented that the length of time since these companies last sought a rate increase somehow justifies the size of the increases proposed. While Staff witness Rukosuev recognized that the rate increases in this docket may cause rate shock, he did not propose any method to alleviate rate shock, relying in part on the length of time since some of the last rate orders. Staff Ex. 5.0 at 32-33. The notion that the length of time since the last rate increase justifies increases of more than 50% is groundless and contradicts the basic premise of utility ratemaking that consumers are obligated to pay tariffed rates, and utilities are entitled to seek to change those rates at their discretion. “In periods when the utility does not seek a rate increase, ratepayers are entitled to presume that the utility has an adequate opportunity to earn a reasonable rate of return.” AG Ex. 2.0 at 7. The length of time that these utilities allowed to pass before seeking these increases at best shows that their revenues were sufficient to enable them to access capital for needed investment, and at worst shows poor management resulting in both substandard financial performance and unreasonable rate shock when steps to belatedly recover costs are finally taken. As pointed out by AG witness Brosch: “Ratepayers do not inherently ‘owe’ the Companies higher rates in the future because of past

decisions of management to not ask for revenue changes when needed. On the contrary, consumers are entitled to rely on the rates established by the Commission that they are routinely billed pursuant to tariff.” AG Ex. 2.0 at 8.

The Public Utilities Act includes the premise that rates for essential utility services must be affordable and services must be available to consumers throughout the state. Specifically, the Public Utilities Act provides the following Findings and Intent:

The General Assembly finds that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens. It is therefore declared to be the policy of the State that public utilities shall continue to be regulated effectively and comprehensively. It is further declared that the goals and objectives of such regulation shall be to ensure...”. Then, among the listed goals and objectives is the following: (d) Equity: the fair treatment of consumers and investors in order that (i) the public health, safety and welfare shall be protected; (ii) the application of the rates is based on public understandability and acceptance of the reasonableness of the rate structure and level; (iii) the cost of supplying public utility services 191 is allocated to those who cause the costs to be incurred; (iv) if factors other than cost of service are considered in regulatory decisions, the rationale for these actions is set forth; (v) regulation allows for orderly transition periods to accommodate changes in public utility service markets; (vi) regulation does not result in undue or sustained adverse impact on utility earnings; (vii) the impacts of regulatory actions on all sectors of the State are carefully weighed; (viii) **the rate for utility services are affordable and therefore preserve the availability of such services to all citizens.**

220 ILCS 5/1-102 (emphasis added). The People asked AG witness Brosch to develop a plan to address “public understandability and acceptance” of UI’s proposed rate change that double and in some instances nearly quadruple existing monthly charges to ratepayers. As Mr. Brosch stated: “The proposed rates raise serious concerns regarding affordability and the preservation of availability of services to all ratepayers of these UI water and sewer utilities. The suddenness and size of the proposed rate increases undermines this generally accepted ratemaking principle.”

AG Ex. 1.0 at 10.

Consumer comments in response to the proposed rate increases provide an independent measure of “public understandability and acceptance.” In response to a 2007 amendment to the Public Utilities Act, the Commission established a “public comment” process where consumers can enter comments on rate increases on e-docket or can directly address the Commission in open meetings. PA 95-127, 220 ILCS 5/2-107. Special provisions were enacted for water utilities. 220 ILCS 5/8-306(n). The General Assembly directed the hearing examiner to review public comments when drafting a recommended or tentative order. *Id.*

The Commission can consider the consumer response to the rate increase notices to inform its decision on how to manage the large increases proposed in this docket. Many comments have already been filed by consumers on e-docket in these cases. In response to Charmar’s proposed 280% increase, one customer stated that:

If my Mother has to pay that high of a rate she would not be able to buy food, she is on a fixed income and if she can't afford the water bill, it would then fall on my shoulders, I also am on a fixed income and on a very strict budget, I also would not be able to afford food or medications. I am asking the, ICC to deny this exorbitant increase.

Albert Scott, public comment filed September 21, 2011 under Docket No. 11-0561. Another Charmar customer noted that, “WE CANNOT AFFORD THIS INCREASE. MOST OF THE RESIDENTS IN THIS NEIGHBORHOOD ARE ELDERLY AND ON FIXED INCOMES. WE HAVE BEEN HERE SINCE THE NEIGHBORHOOD WAS DEVELOPED, FOR 57 YEARS. WE ARE OPPOSED TO AN INCREASE FOR CHARMAR WATER COMPANY.” Marie Miller, public comment filed August 16, 2011 under Docket No. 11-0561. Although Charmar only serves fifty-three customers, fifteen public comments were posted on the Commission’s official comments forum as of February 21, 2012, all commenting on the size of the large proposed rate increase.

Customers of the other utilities posted similar comments in response to requested rate increases. As of February 21, 2012, Cherry Hill had seven public comments, Killarney had 42, Clarendon had 17, Ferson Creek had 22, and Harbor Ridge had one. One Cherry Hill customer stated that:

The proposed increase of 100% is going to come at such a time as to put many families over the [edge] as far as finances are concerned . . . In such hard economical times as the public is facing it would be fair to the public if an increase was spread over a longer period of time A 100% increase all at once would be a disaster to many families already facing financial hardships.

Thomas Nolan, public comment filed October 31, 2011 under Docket No. 11-0562. A Killarney customer voiced a similar concern, noting that the company should “compromise with your customers....yes you are working for us and providing a service. Earn it and our respect by cutting down the amount requested or at the very least in smaller increments over a few years.”

Cheryl Brockhoeft, public comment filed January 27, 2012 under Docket No. 11-0564.

And many customers of the utilities posted comments stating that the quality of the water they receive is very low. As one Clarendon customer noted, “The per month increase the Clarendon Water Company is asking for is simply OUTRAGEOUS. The water is terrible. You cannot drink it, it tastes AWFUL. It has ruined my pipes, sinks, toilet, etc. I have a water softener and it STILL doesn't help the quality of this water.” Sue Williams, public comment filed

November 29, 2011 under Docket No. 11-0563. A family of Killarney customers stated that:

The water quality they supply is sub-standard and is often a visibly brown from the high content of iron and other pollutants and it should be boiled to be safe for consumption. The water requires the use of water softeners and filtering and it can damage clothes washed in it if not treated properly. The Killarney Water Company frequently issues boil orders to protect our health.

Dennis and Kathy Oleksy, public comment filed January 30, 2012 under Docket No. 11-0564.

Another Killarney customer argued that:

I can testify to the fact that the Killarney Water Co. has been delivering an extremely poor quality product for years I'm forced to pay for a water softener, salt, an R/o unit and filters just to make the water usable and drinkable. In this economy to expect senior citizens and others to pay an unjustified increase of 248% is outrageous and unbelievable. Please don't let this increase happen!

Victoria Etters, public comment filed January 30, 2012 under Docket No. 11-0564.

One Ferson Creek Water customer stated: "What a shame. You haven't asked for an increase since 1984, so now you want to make up for lost time. As a senior living on social security & a small pension I find it very hard to digest this." Gregory Mittman, public comment filed October 31, 2011 under Docket No. 11-0565. Another stated that, "Under the current economic conditions an increase of this magnitude is ridiculous. The company maintains that it has had no increases in its rate since 1984. If this is the case why were previous application[s] for an increase not made[?]" Joe Renwick, public comment filed October 25, 2011 under Docket No. 11-0565.

The Commission has scheduled a public meeting on March 6 in Crystal Lake. See Notice of Public Forum, dated February 6, 2012. This meeting will take place after briefing, and it is unknown whether the transcript will be available before the Administrative Law Judge issues his proposed order. As shown in Table 1 on page 1-2 of this Initial Brief, these utilities are located in several counties. It is unclear how many consumers will be close enough to the Crystal Lake, which is in McHenry County, meeting to attend.

2. The recommended phase-in plan will help ameliorate rate shock while allowing the Companies to recover the full rate base increase amounts over time.

The Commission and the utility have tools available to them to alleviate rate shock when a utility seeks such large increases. As recently as December 21, 2011, the Commission ordered rehearing and directed UI and the parties in Docket 11-0059 consolidated, to address ways to

alleviate the rate shock stemming from increases of 48% to 250%. Order on Rehearing (Dec. 21, 2011), ICC Docket 11-0059. Similarly, UI has been subject to phase-in plans in other states. Attached to AG witness Brosch's Rebuttal testimony are a Tennessee Order and a Maryland Order that approved phase-in plans to address rate increases that were substantially smaller than the ones the utilities request in this docket. In Tennessee, the utilities requested an increase of 70%. AG Ex. 2.3 at 8. In Maryland, the utilities requested increases ranging from 38-47% for water services and 70% for sewer services. AG Ex. 2.2 at 2. Only AG witness Brosch offered a rate phase-in plans to "make the transition to higher rates less drastic and sudden." AG Ex. 1.0 at 11. "The phase-in plan would allow the Company to recover the portion of its ultimately authorized revenue requirements, the deferred expense amounts, through gradually increased rates." AG Ex. 2.0 at 13.

The phase-in plan would increase rates the larger of \$10 per month per year (equaling \$120 per year) or 20% of an average bill per year. This approach is similar to the approach approved by the Commission for Commonwealth Edison costs that increased by a much smaller amount, where the Commission limited the increase due to energy charges to 10% per year for three years. Order at 2, ICC Docket 06-0411 (Dec. 20, 2006). In Mr. Brosch's plan, each year the utility would defer for future recovery the amount of revenue that exceeds these guidelines. AG Ex. 2.1 shows the application of the phase-in plan to each utility's requested (rebuttal) revenue requirement. In summary, the phase-in would take between 0 and 10 years, as shown below:

Table 7: Phase-in Schedule

Utility Name	Percentage Increase	Number of Years for Phase-In
Charmar	284%	9 years
Cherry Hill	99%	5 years
Clarendon	140%	7 years
Killarney	208%	7 years
Ferson Creek	W - 83% S- 77%	W- 5 years S- 5 years
Harbor Ridge	W-82% S-103%	W- 4 years S – 0 years

Source: AG Ex. 2.0 at 6 & AG Ex. 2.1

In response to the utilities concern about compensating shareholders during the phase-in period, and if the Commission so directs, Mr. Brosch’s plan, included in AG Ex. 2.1, would allow the utilities to defer the unpaid revenue requirement and receive a return on the net-of-tax regulatory asset balance containing deferred O&M balance equal to the long-term debt interest rate, while providing adequate time for consumers to acclimate to the higher rates. AG Ex. 2.0 at lines 198-210. However, the need for interest on the deferred balance is far from clear. At current rate levels, the Company has invested millions of dollars into these utilities. It has identified no upcoming obligations that would be blocked or frustrated as a result of the phase-in plan. Further, as Mr. Brosch observed: “The Company has demonstrated its ability to finance much larger projects than the deferred expenses associated with an Illinois rate increase phase-in plan over long periods of time.” AG Ex. 2.0 at 16. The phase-in plan is fair to consumers and to the Company.

Staff witness Rukosuev expressed opposition to the phase-in plan. Staff Ex. 11.0 at 3. However, his opposition is based on assumptions that are not supported by evidence in the record. For example, he is concerned that the phase-in plan be voluntary for consumers, without regard to how the Company would manage a plan where participation is less than universal.

Nevertheless, the People do not oppose offering the phase-in plan on a voluntary basis. Mr. Rukosuev also argues that a phase-in plan is inappropriate because “each subsidiary of UI is its own corporate entity and not related or connected to any other UI subsidiary, except through ownership by the parent corporation”. *Id* at 14. His statement is contradicted by the undisputed evidence that the WSC, a subsidiary of the utilities’ parent company UI, provides all of the employees and operational support to each utility and that none of the utilities have *any* employees. Co. Ex. 1.0 at 2 (each utility). In addition, all utilities use the Project Phoenix and JDE system for customer service, accounting, customer billing and financial and regulatory reporting, capital projects, fixed assets, equipment management and general ledger. Co. Ex. 1.0 at 6-7. resources, which each utility identified as a driver of the rate increase. In addition, as Mr. Brosch pointed out, the parent maintains “a centralized cash management system where customer deposit accounts are swept into a single depository account and all checks are written from a single disbursement account.” AG Ex. 1.0 at 20-22 (each utility). The evidence before the Commission plainly shows that Mr. Rukosuev’s premise that these utilities are unrelated is erroneous.

Similarly, Mr. Rukosuev cited a string of other UI rate increases, where no phase-in was required in arguing against Mr. Brosch’s phase-in proposal. Staff Ex. 11.0 at 15-16. However, since the filing of his testimony, the Commission granted rehearing specifically to alleviate rate shock. Tr. at 296-297. As a result, two of the three triple digit increases are subject to rehearing, leaving the increases granted by the Commission at 66.1% or less. Staff Ex. 11.0 at 15-16. In the other docket involving Northern Hills, Docket 10-0298, the utility and the Staff were the only parties.

The People request that the Commission adopt the phase-in described by Mr. Brosch to alleviate rate shock if the large increases requested in this docket are allowed.

III. CONCLUSION

The People respectfully request that the Commission reduce the requested revenue increase for each of these utilities to remove excessive rate case expenses, to remove cash working capital from rate base, and to decrease the ROE to 8.035% and the weighted cost of capital to 7.30%. Further, if the Commission enters a revenue requirement that will increase rates by more than \$10 or 20% per month, the People request that the phase-in plan described by AG witness Brosch be adopted to alleviate the rate shock that the extraordinary resulting rate increases.

Respectfully Submitted,

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